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NO.

IN THE

Supreme Court of The United States

OCTOBER TERM, 1991

PHOENIX MUTUAL LIFE INSURANCE COMPANY,

Cross-Petitioner,

v.

GREYSTONE III JOINT VENTURE,

Cross-Respondent.

ON CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

CROSS-PETITION FOR A WRIT OF CERTIORARI

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18

QUESTION PRESENTED

WHETHER THE ABSOLUTE PRIORITY RULE AS CODIFIED IN CHAPTER 11 OF THE UNITED STATES BANKRUPTCY CODE PERMITS CONFIRMATION, OVER THE OBJECTION OF AN UNDERSECURED CREDITOR, OF A PLAN OF REORGANIZATION WHICH (A) PROVIDES FOR DISCHARGE OF THE OBJECTING CREDITOR'S UNSECURED CLAIM BY DISTRIBUTING TO THE OBJECTING CREDITOR A MINUSCULE FRACTION OF THE OBJECTING CREDITOR'S UNSECURED CLAIM, BUT (B) VESTS IN THE DEBTOR'S PRINCIPALS THE EXCLUSIVE RIGHT TO RETAIN OWNERSHIP OF THE DEBTOR'S PROPERTY BY CONTRIBUTING CAPITAL, AND (C) PREVENTS THE OBJECTING CREDITOR FROM SUBMITTING A COMPETING PROPOSAL.

INDEX

	PAGE
QUESTION PRESENTED	1
STATEMENT REGARDING PARTIES	2
OPINIONS BELOW	2
JURISDICTION	3
ADDITIONAL PERTINENT STATUTORY PROVISIONS	3
STATEMENT OF THE CASE	4
A. *Relevant facts*	4
B. *The decisions below*	5
REASONS FOR GRANTING THE WRIT	6
A. *Review on certiorari of the issue presented in this cross petition is warranted pursuant to Supreme Court Rules 10.1(a) and (c) because the issue constitutes an extremely important question of federal law which has not been, but should be, settled by this Court, and is the subject of conflicting decisions by United States Courts of Appeals.*	6
1. *Lower courts are hopelessly divided on the issue, and the issue is the subject of conflicting United States Court of Appeals decisions.*	6
2. *The better reasoned decisions, including the Fifth Circuit's original Greystone opinion, demonstrate that, at least to the extent contemplated by Greystone's plan, the exception to the absolute priority rule did not survive passage of the Code.*	9
CONCLUSION	13

TABLE OF AUTHORITIES

PAGE

CASES

In re Bjolmes Realty Trust, 134 B.R. 1000 (Bankr. D. Mass. 1991) 8

Case v. Los Angeles Lumber Products Co., 308 U.S. 106 (1939) 7, 9, 10

In re Drimmel, 135 B.R. 410 (D. Kan. 1991) 7

In re Greystone III Joint Venture, 102 B.R. 560 (Bankr. W.D. Tex. 1989) 5

In re Greystone III Joint Venture, 127 B.R. 138 (W.D. Tex. 1990). 5

Kahm & Nate's Shoes v. First Bank of Whiting, 908 F.2d 1351 (7th Cir. 1990) 7

In re Lumber Exchange Ltd. Partnership, 125 B.R. 1000 (Bankr. D. Minn. 1991) 8

Nixon v. Fitzgerald, 457 U.S. 731 (1982) 8

Northern Pacific Railway Co. v. Boyd, 228 U.S. 482 (1913) 12

Norwest Bank Worthington v. Ahlers, 485 U.S. 197, n. 3 (1988) 6, 7, 8, 9, 11, 12

In re Outlook/Century, Ltd., 127 B.R. 650 (Bankr. N.D. Cal. 1991) 8, 10, 12

Phoenix Mutual Life Insurance Company v. Greystone III Joint Venture (In re Greystone III Joint Venture), (5th Cir. 1991) 6

Piedmont Associates v. Cigna Property & Casualty Insurance Co., 132 B.R. 75 (N.D. Ga. 1991) 7

In re Professional Development Corp., 22 BCD 441 (Bankr. W.D. Tenn. 1991) 7

In re Pullman Construction Industries, Inc., 107 B.R. 909 (Bankr. N.D. Ill. 1989) 8

PAGE

In re Ribbs Auto Sales, Incorporated, ___ B.R. ___, 1992 WL 105619, Slip Opinion p. 5 (Bankr. E.D. Va. May 14, 1992) 7

In re SLC Limited V, 22 BCD 1081 (Bankr. D. Utah 1992) 7

In re Tallahassee Associates, L.P., 132 B.R. 712 (Bankr. W.D. Pa. 1991) 7

Teamsters National Freight Industries Negotiating Committee v. U.S. Truck Company (In re U.S. Truck Company, Inc., 800 F.2d 581 (6th Cir. 1986) 8

Travelers Insurance Company v. Bryson Properties (In re Bryson Properties XVIII), ___ F.2d ___, 22 BCD 1391 (4th Cir. 1992) 7, 8, 11

In re Triple R Holdings, L.P., 134 B.R. 382 (Bankr. N.D. Cal. 1991) 8

United States v. Ron Pair Enterprises, Inc., 489 U.S. 235 (1989) 10

In re Woodscape Limited Partnership, 134 B.R. 165 (Bankr. D. Md. 1991) 8

STATUTES

11 U.S.C. § 1101, et seq. . . . . passim

11 U.S.C. § 1129 11

28 U.S.C. § 1254(1) 3, 8

RULES

Supreme Court Rule 10.1(a) 6

Supreme Court Rule 10.1(c) 6

Supreme Court Rule 12.3 1

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CROSS-PETITION FOR A WRIT OF CERTIORARI

Pursuant to Supreme Court Rule 12.3 Cross-Petitioner Phoenix Mutual Life Insurance Company ("Phoenix") submits this cross-petition for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit ("the Fifth Circuit"), for review of the Fifth Circuit's partial grant of the suggestion for rehearing en banc filed in the Fifth Circuit by Cross-Respondent Greystone III Joint Venture ("Greystone"):

QUESTION PRESENTED

WHETHER THE ABSOLUTE PRIORITY RULE AS CODIFIED IN CHAPTER 11 OF THE UNITED STATES BANKRUPTCY CODE PERMITS CONFIRMATION, OVER THE OBJECTION OF AN UNDERSECURED CREDITOR, OF A PLAN OF REORGANIZATION WHICH (A) PROVIDES FOR DISCHARGE OF THE OBJECTING CREDITOR'S UNSECURED CLAIM BY DISTRIBUTING

TO THE OBJECTING CREDITOR A MINUSCULE FRACTION OF THE OBJECTING CREDITOR'S UNSECURED CLAIM, BUT (B) VESTS IN THE DEBTOR'S PRINCIPALS THE EXCLUSIVE RIGHT TO RETAIN OWNERSHIP OF THE DEBTOR'S PROPERTY BY CONTRIBUTING CAPITAL, AND (C) PREVENTS THE OBJECTING CREDITOR FROM SUBMITTING A COMPETING PROPOSAL.

STATEMENT REGARDING PARTIES

The parties to this case are listed in the petition ("Greystone's petition") for a writ of certiorari filed in this Court by Greystone and the brief ("Phoenix's brief") filed in this Court by Phoenix in opposition to Greystone's petition.

OPINIONS BELOW

The opinion of the Fifth Circuit partially granting Greystone's suggestion for rehearing appears beginning at page A-3 of the appendix to Greystone's petition and is published at 948 F.2d at 142. The opinion of the Fifth Circuit as modified on rehearing is published at 948 F.2d 134. The original opinion of the Fifth Circuit appears beginning at page A-6 of the appendix to Greystone's petition. The opinion of the United States District Court for the Western District of Texas, Austin Division ("the District Court"), appears beginning at page A-42 of the appendix to Greystone's petition and is published at 127 B.R. 138. The opinion of the United States Bankruptcy Court for the Western District of Texas, Austin Division ("the Bankruptcy Court"), appears beginning at page A-72 of the appendix to Greystone's petition and is published at 102 B.R. 560.

JURISDICTION

The Fifth Circuit's original decision was dated November 19, 1991. The Fifth Circuit's decision partially granting Greystone's suggestion for rehearing was dated February 27, 1992. Greystone's petition was filed in this Court on May 27, 1992. This cross-petition is filed within 30 days of May 27, 1992. Jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

ADDITIONAL PERTINENT STATUTORY PROVISIONS

In addition to the statutes quoted in Greystone's petition and Phoenix's brief, the following statute is pertinent:

"11 U.S.C. § 1129 Confirmation of plan

* * *

(b)(1) If all of the applicable requirements of Subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

* * *

(B) With respect to a class of unsecured claims —

(i) The plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) The holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property."

STATEMENT OF THE CASE

A. Relevant facts.

As stated in Greystone's petition and Phoenix's brief, Greystone's principal asset was an office building ("the building") located in Austin, Texas. Phoenix was the owner and holder of a promissory note ("the note") in the original principal amount of $8.8 million executed by Greystone. Payment of the note was secured by a deed of trust ("the deed of trust") encumbering the building.

On the eve of a scheduled foreclosure of the deed of trust, Greystone commenced in the Bankruptcy Court a voluntary case ("Greystone's Chapter 11 case") for relief under Chapter 11 of the United States Bankruptcy Code ("the Code"). As of the commencement of Greystone's Chapter 11 case, the unpaid balance of principal and interest owing on the note was $9,300,773.60. The Bankruptcy Court in Greystone's Chapter 11 case determined that the value of the building was $5,825,000. Thus, Phoenix filed in Greystone's Chapter 11 case proofs of a secured claim ("Phoenix's secured claim") in the amount of $5,825,000 and an unsecured claim ("Phoenix's unsecured claim") of $3,475,773.60.

Greystone proposed in Greystone's Chapter 11 case a plan of reorganization ("Greystone's plan") which contemplated (a) discharging creditors' unsecured claims, including Phoenix's unsecured claim, by distributing to each unsecured creditor 3.82% of the amount of each unsecured creditor's claim; and (b) vesting in Greystone's principals the exclusive right to retain 100% of the ownership of the building by contributing a capital infusion of $500,000. Phoenix voted Phoenix's secured claim and Phoenix's unsecured claim to reject Greystone's plan, and opposed confirmation of Greystone's plan on the ground, *inter alia*, that Greystone's plan violated the absolute priority rule by allowing Greystone's principals to retain ownership of the building without fully paying Phoenix's unsecured claim. A class consisting of unsecured claims aggregating $10,000 held by Greystone's trade creditors ("the trade creditors") voted to accept Greystone's plan. At the hearing on confirmation of Greystone's plan the Bankruptcy Court rejected Phoenix's request to propose and fund a plan of reorganization which would fully pay all other creditors' claims and provide capital for repairs and maintenance of the building.

B. The decisions below.

The Bankruptcy Court confirmed Greystone's plan, *In re Greystone III Joint Venture*, 102 B.R. 560 (Bankr. W.D. Tex. 1989), reasoning, among other things, that an exception to the absolute priority rule pursuant to which a "junior interest holder might retain an interest in the enterprise even though senior classes were not fully paid provided the junior interest holder had made a cash infusion" 102 B.R. at 573 was "still good law, as it represents nothing more than an extension of the fair and equitable concept to embrace the need for new capital for the venture" 102 B.R. at 575.

The District Court affirmed the Bankruptcy Court, *In re Greystone III Joint Venture*, 127 B.R. 138 (W.D. Tex. 1990), expressing agreement "with the Bankruptcy Judge's determination that" the exception to the absolute priority rule "remains

vital," and concluding that the Bankruptcy Court's factual determination "that the most feasible source of funding was from the current owners of the partnership, rather than from Phoenix" was not clearly erroneous, 127 B.R. at 142-43.

The Fifth Circuit initially reversed those determinations of the Bankruptcy Court and District Court, *Phoenix Mutual Life Insurance Company v. Greystone III Joint Venture (In re Greystone III Joint Venture)*, (5th Cir. 1991) (Appendix to Greystone's petition, pp. A-6 to A-41), holding, *inter alia*, that (a) neither "in the Code's language, nor in the context of a previous, different reorganization law, nor in legislative history, nor in policy is there room for a 'new value exception' to the absolute priority rule . . . " (Appendix to Greystone's petition, p. A-40); and (b) the Bankruptcy Court "erred in refusing to consider Phoenix's proposed equity contribution along with that of former equity" (Appendix to Greystone's petition, p. A-41). However, on rehearing the Fifth Circuit withdrew those holdings, emphasizing that the Bankruptcy Court's "opinion on the 'new value exception' to the absolute priority rule has been vacated and we express no view whatever on that part of a bankruptcy court's decision" 948 F.2d at 142.

REASONS FOR GRANTING THE WRIT

A. *Review on certiorari of the issue presented in this cross-petition is warranted pursuant to Supreme Court Rules 10.1(a) and (c) because the issue constitutes an extremely important question of federal law which has not been, but should be, settled by this Court, and is the subject of conflicting decisions by United States Courts of Appeals.*

1. *Lower courts are hopelessly divided on the issue, and the issue is the subject of conflicting United States Court of Appeals decisions.*

In *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 203, n. 3 (1988), this Court discussed, but did not decide, the extent, if

any, to which codification in 1978 of the absolute priority rule in the Code incorporated an exception to the absolute priority rule which had been suggested by dicta in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939); however, this Court in *Ahlers* observed that whether Congress "meant to retain the *Los Angeles Lumber* exception to the absolute priority rule when it codified the rule in Chapter 11" was "a proposition that can be debated" 485 U.S. at 205, and that "the continuing vitality of the *Los Angeles Lumber* exception" was a "question which has divided the lower courts since passage of the Code in 1978" 485 U.S. at 203-204, n. 3. That division in the lower courts has proliferated enormously since this Court's *Ahlers* decision, *see Travelers Insurance Company v. Bryson Properties (In re Bryson Properties XVIII)*, ___ F.2d ___, 22 BCD 1391, 1394-95 (4th Cir. 1992) (Holding that because the "exclusive right to contribute constitutes 'property' . . . which was received or retained on account of a prior interest", even if "some limited new capital exception were viable under the Bankruptcy Code it would not be so expansive as to apply under the facts of this case," in that "here the Debtors have carried their opportunity for self-dealing too far"); *Kahm & Nate's Shoes v. First Bank of Whiting*, 908 F.2d 1351, 1360-63 (7th Cir. 1990) (Questioning whether the exception survived passage of the Code but declining to decide the issue); *In re Ribbs Auto Sales, Incorporated*, ___ B.R. ___, 1992 WL 105619, Slip Opinion p. 5 (Bankr. E.D. Va. May 14, 1992) (Opining that the exception did not survive passage of the Code); *In re SLC Limited V*, 22 BCD 1081, 1082-1085 (Bankr. D. Utah 1992) (Holding that the exception survived passage of the Code); *In re Professional Development Corp.*, 22 BCD 441, 442-43 (Bankr. W.D. Tenn. 1991) (Holding that the exception survived passage of the Code); *In re Tallahassee Associates, L.P.*, 132 B.R. 712, 716-718 (Bankr. W.D. Pa. 1991) (Holding that the exception survived passage of the Code); *Piedmont Associates v. Cigna Property & Casualty Insurance Co.*, 132 B.R. 75, 78-79 (N.D. Ga. 1991) (Holding that the exception did not survive passage of the Code); *In re Drimmel*, 135 B.R. 410, 415-417 (D. Kan. 1991)

(Holding that the exception did not survive passage of the Code); *In re Bjolmes Realty Trust*, 134 B.R. 1000, 1004-1008 (Bankr. D. Mass. 1991) (Holding that the exception survived passage of the Code); *In re Triple R Holdings, L.P.*, 134 B.R. 382, 384-387 (Bankr. N.D. Cal. 1991) (Holding that the exception survived passage of the Code); *In re Woodscape Limited Partnership*, 134 B.R. 165, 168-175 (Bankr. D. Md. 1991) (Holding that the exception survived passage of the Code); *In re Outlook/Century, Ltd.*, 127 B.R. 650, 653-658 (Bankr. N.D. Cal. 1991) (Holding that the exception did not survive passage of the Code); *In re Lumber Exchange Ltd. Partnership*, 125 B.R. 1000, 1006-1008 (Bankr. D. Minn. 1991) (Holding that the exception did not survive passage of the Code); *In re Pullman Construction Industries, Inc.*, 107 B.R. 909, 946-48 (Bankr. N.D. Ill. 1989) (Holding that the exception survived passage of the Code).

The issue is, moreover, the subject of conflicting decisions by United States Courts of Appeals; the Fourth Circuit's holding in *Bryson Properties XVIII, supra*, conflicts with the Sixth Circuit's pre-*Ahlers* holding in *Teamsters National Freight Industries Negotiating Committee v. U.S. Truck Company (In re U.S. Truck Company, Inc.)*, 800 F.2d 581, 587-88 (6th Cir. 1986) that the exception remained viable after passage of the Code.

Although the Fifth Circuit on rehearing withdrew those portions of the Fifth Circuit's original *Greystone* opinion which addressed the viability of the exception after passage of the Code, the issue was nevertheless "in" the Fifth Circuit for purposes of this Court's jurisdiction under 28 U.S.C. §1254(1), *Nixon v. Fitzgerald*, 457 U.S. 731, 742 (1982). Moreover, because the issue is a "pure issue of law" which is "serious and unsettled", concerns of judicial economy fully warrant this Court's resolution of the important issue, *Nixon, supra*, 457 U.S. at 743 and n. 23.

2. *The better reasoned decisions, including the Fifth Circuit's original Greystone opinion, demonstrate that, at least to the extent contemplated by Greystone's plan, the exception to the absolute priority rule did not survive passage of the Code.*

This Court stated in *Ahlers*, 485 U.S. at 202, that the "absolute priority rule 'provides that a dissenting class of unsecured creditors must be provided for in full before any junior class can receive or retain any property'" under a reorganization plan; that the rule "had its genesis in judicial construction of the undefined requirement of the early bankruptcy statute that reorganization plans be 'fair and equitable'"; that the rule "has since gained express statutory force, and was incorporated into Chapter 11 of the Bankruptcy Code adopted in 1978. *See* 11 U.S.C. § 1129(b)(2)(B)(ii) . . ."; and that under "current law, no Chapter 11 reorganization plan can be confirmed over the creditors' legitimate objections . . . if it fails to comply with the absolute priority rule." The dicta in *Case v. Los Angeles Lumber Products Co.*, *supra*, 308 U.S. at 121-122, suggesting an exception to the absolute priority rule, stated that there were "circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor" by a "contribution in money or money's worth, reasonably equivalent in view of all of the circumstances to the participation of the stockholder." This Court observed in *Ahlers*, 485 U.S. at 205, that whether "Congress meant to retain the *Los Angeles Lumber* exception to the absolute priority rule when it codified the rule in Chapter 11" was "a proposition that can be debated." Better reasoned decisions, including the Fifth Circuit's original *Greystone* decision, demonstrate that, at least to the expansive extent contemplated in Greystone's plan, Congress did not retain the exception in the Code's codification of the absolute priority rule.

First, the Code's clear and unambiguous codification of the absolute priority rule does not mention the exception. As Greystone's petition (p. 15) staunchly asserts, "The plain meaning of legislation should be conclusive, except in the rare cases in which

the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters" *see United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242 (1989) ("The plain meaning of legislation should be conclusive, except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters'"); *In re Outlook/Century, Ltd., supra*, 127 B.R. at 657 (Congress' adoption of a statutory definition of the absolute priority rule that "contains no new value exception . . . constitutes strong evidence that Congress intended to eliminate the new value exception to the absolute priority rule").

Moreover, the Fifth Circuit's original *Greystone* opinion (Appendix to Greystone's petition, p. A-34) appropriately observed that when *Case* was decided, a plan could be confirmed only if the plan was both (a) fair and equitable, and (b) accepted by each class of creditors, *Case v. Los Angeles Lumber Co., supra*, 308 U.S. at 114, n. 6, but under the Code a plan accepted by all classes need not satisfy the statutorily defined absolute priority rule. Thus, any plan which could have been confirmed when *Case* was decided could be confirmed under the Code regardless of whether the plan complied with the absolute priority rule; furthermore, because Greystone's plan was not accepted by each class of creditors, Greystone's plan could not have been confirmed when *Case* was decided regardless of whether Greystone's plan complied with the absolute priority rule. *See In re Outlook/Century Ltd.*, 127 B.R. 650, 657 (To cite *Case* as "supporting a new value under Section 1129(b)(2)(B) is to cite the language of the decision without reference to the context in which it arose"). Thus, the Fifth Circuit's original *Greystone* opinion (Appendix to Greystone's petition, p. A-34) aptly stated that the "increased flexibility" in the Code renders "the *Case* exception unnecessary."

The Fifth Circuit's original *Greystone* opinion (Appendix to Greystone's petition, p. A-35) also appropriately reasoned that the use of the term "includes" in the definition of "fair and

equitable" in Section 1129(b) of the Code could not support the argument that the exception survived passage of the Code because the statute sets a "minimum standard for a fair and equitable plan" and the exception would dilute "that minimum requirement."

Additionally, the Fifth Circuit's original *Greystone* opinion (Appendix to Greystone's opinion, pp. A-35 to A-36) appropriately rejected the argument that if "'old equity' infuses new money into the Debtor, it is not retaining its ownership 'on account of' its old equity status"; as the Fifth Circuit's original *Greystone* opinion stated, Greystone "intends to prevent creditors from acceding to ownership of the property on account of Greystone's unique status as an old equity contributor to the plan" and Greystone "desired to prevent a competitive auction of the property, at which Phoenix could credit bid, precisely because of Greystone's old equity status." *See also Travelers Insurance Company v. Bryson Properties XVIII (In re Bryson Properties XVIII), supra,* F.2d , 22 BCD at 1394-95 ("The question is whether the equityholders receive anything 'on account of' their prior interest . . . In the proposed plan the equityholders have given themselves not only the exclusive right to contribute, but the right to return of the new capital prior to Travelers' recovery of its unsecured claim . . . This exclusive right to contribute constitutes 'property' under Section 1129(b)(2)(B)(ii) which was received or retained on account of their prior interest . . . Here, the Debtors have carried their opportunity for self dealing too far").

Furthermore, the Fifth Circuit's original *Greystone* opinion (Appendix to Greystone's petition, p. A-37) aptly rejected arguments that the exception could be an equitable variation from the absolute priority rule because, as this Court held in *Ahlers*, whatever "equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code" 485 U.S. at 206.

Finally, the Fifth Circuit's original *Greystone* opinion (Appendix to Greystone's petition, pp. A-37 to A-38) appropriately disagreed with "the assumption" that the Code "permits a nonconsensual plan to 'sell' the debtor to its old equity owners" because this assumption "flies in the face of the creditor control principal (sic) embodied in Chapter 11 and accepted by *Ahlers*." In *Ahlers* this Court indeed clearly embraced the creditor control concept by stating that (a) the determination of whether creditors are "better off" if a plan is confirmed is "for the creditors to make" and when creditors object to a proposed plan this is "their prerogative under the Code, and courts applying the Code must effectuate their decisions", 485 U.S. at 207; and (b) whether the value of an insolvent debtor's property "is 'present or prospective, for dividends or only for purposes of control' a retained equity interest is a property interest to 'which the creditors [are] entitled . . . before the stockholders [can] retain it for any purpose whatever.'" 485 U.S. at 208, citing *Northern Pacific Railway Co. v. Boyd*, 228 U.S. 482, 508 (1913). *See also In re Outlook/Century, Ltd., supra*, 127 B.R. at 653-54 ("The proposed contribution of capital cannot be considered a 'purchase' in which the partners will receive equity in debtor wholly independent of their existing partnership interest, because it is not an open market transaction. Other potential investors are not permitted to participate. The 'price' for the equity interest in debtor is fixed by debtor's plan; there is no opportunity for persons other than the existing partners to overbid."). Accordingly, the determination in the Fifth Circuit's original *Greystone* opinion regarding the extent to which the exception survived passage of the Code was clearly correct and erroneously withdrawn.

CONCLUSION

For the reasons stated in Phoenix's brief, Greystone's petition should be denied. However, if this Court grants Greystone's petition, this Court should also grant this cross-petition and resolve the important issue of federal law which is the subject of a conflict in the decisions of the United States Courts of Appeals and of hopeless division among the lower courts.

Respectfully submitted,

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